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No. 90-933

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

LAMPF PLEVA LIPKIND PRUPIS & PETRIGROW,

Petitioner,

v.

JOHN GILBERTSON, ET AL.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF THE NATIONAL ASSOCIATION OF SECURITIES AND COMMERCIAL LAW ATTORNEYS AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Pursuant to Rule 37.3 of the Rules of this Court, the National Association of Securities and Commercial Law Attorneys ("NASCAT") respectfully moves for leave to file the enclosed brief as amicus curiae in support of respondents. Counsel for respondents has granted consent to file this brief. Counsel for petitioner also has granted consent to file this brief.

NASCAT is an association of law firms consisting of approximately 500 attorneys located throughout the United States whose purpose is to promote the enactment and enforcement of legislation which protects investors from deceptive and manipulative practices and ensures that the securities markets in the United States can operate in a fair and free manner. NASCAT members have represented plaintiffs in a variety of individual and class action contexts under

the federal securities laws; some NASCAT members have also represented defendants in securities and other cases.

NASCAT and its members have a strong interest in the effective private enforcement of the federal securities laws and in the development of case law that effectively deters would-be wrongdoers from perpetrating securities fraud upon public investors. Because of this Court's repeated endorsement of the flexible interpretation and need for private enforcement of the federal securities laws, the issues raised by this appeal are extremely important to the investment community and the capital markets generally.

The enclosed amicus curiae brief addresses selection of a statute of limitations to be applied to the right of action implied under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5 thereunder, 17 C.F.R. §240.10b-5.

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BRIEF OF THE NATIONAL ASSOCIATION OF SECURITIES AND COMMERCIAL LAW ATTORNEYS AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

TABLE OF CONTENTS

	PAGE
QUESTIONS PRESENTED	1
INTEREST OF THE AMICUS CURIAE	2
SUMMARY OF THE ARGUMENT	2
I. A NON-TOLLABLE ONE YEAR/THREE YEAR STATUTE OF LIMITATIONS IS NOT APPROPRIATE FOR APPLICATION TO 10b-5 CLAIMS	3
A. Characterization Of A Section 10(b) claim	7
B. The One-Year/Three Year Rule Does Not Provide A "Closer Analogy" To Section 10(b) Than Available State Law Fraud Statutes	10
C. Federal Policies At Stake And The Practicalities Of Litigation Do Not Make The One-Year/Three-Year Rule A More Appropriate Vehicle For Interstitial Lawmaking	13
D. The One-Year/Three-Year Statute Is Non-Tollable And Eliminates For The First Time The Equitable Tolling Of A Limitation Period Applicable To A Fraud Claim	14
E. The One-Year/Three-Year Period Would Undermine The Private Enforcement Of The Securities Laws	18
II. THE FIVE-YEAR STATUTE OF LIMITATIONS IN SECTION 20A OF THE SECURITIES ACT OF 1934 IS "MORE ANALOGOUS" THAN THE ONE-YEAR/THREE-YEAR PERIOD AND WOULD PROMOTE, RATHER THAN EVISCERATE, THE PRIVATE ENFORCEMENT OF THE SECURITIES LAWS	22

	PAGE
III. ANY STATUTE OF LIMITATIONS WHICH MAY BE SELECTED FROM FEDERAL LAW AND APPLIED TO SECTION 10(b) CLAIMS SHOULD NOT BE RETROACTIVE	24
IV. CONCLUSION	25

TABLE OF AUTHORITIES

CASE

	PAGE
Agency Holding Corp. v. Malley-Duff & Assoc., Inc., 483 U.S. 143 (1987)	6-7,8,9
American Pipe & Construction Co. v. Utah, 414 U.S. 538 (1974)	16
Bailey v. Glover, 88 U.S. 342 (1875)	15
Basic, Inc. v. Levinson, 485 U.S. 224 (1988)	passim
Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299 (1985)	19
Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)	7
Board of Regents v. Tomanio, 446 U.S. 478 (1980)	16
Breen v. Centex Corp., 695 F.2d 907 (5th Cir. 1983)	17
Bresson v. Thomson McKinnon Securities Inc., 118 F.R.D. 339 (S.D.N.Y. 1988)	20
Burnett v. New York Central R.R., 380 U.S. 424 (1965)	16
Ceres Partners v. GEL Associates, 918 F.2d 349 (2d Cir. 1990)	passim
Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)	24,25
Davis v. Birr, Wilson & Co., 839 F.2d 1369 (9th Cir. 1988)	9
Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)	7,10, 11-12
Exploration Co. v. United States, 247 U.S. 435 (1918)	15,16,18
Glus v. Brooklyn Eastern District Terminal, 359 U.S. 231 (1959)	15

	PAGE
Gruber v. Price Waterhouse, 911 F.2d 960 (3d Cir. 1990)	25
Harris v. Union Electric Co., 787 F.2d 355 (8th Cir.), *cert. denied*, 479 U.S. 823 (1986)	17
Haumann v. Illinois Power Co., et. al, Civil Action No. 89-1130 (C.D. Ill. December 4, 1990)	25
Herm v. Stafford, 663 F.2d 669 (6th Cir. 1981)	17
Herman & MacLean v. Huddleston, 459 U.S. 375 (1983)	passim
Holmberg v. Armbrecht, 327 U.S. 392 (1946)	13,15,16
Holmes v. Bateson, 583 F.2d 542 (1st Cir. 1978)	17
In re Data Access Securities Litigation, 843 F.2d 1537 (3d Cir.), *cert. denied*, 488 U.S. 849 (1988)	passim
In re Home-Stake Production Co. Securities Litigation, 76 F.R.D. 351 (N.D. Okla. 1977)	20
In re National Smelting of New Jersey, Inc. Bondholders' Litigation, 722 F. Supp. 152 (D.N.J. 1989)	24
In re VMS Securities Litigation, 89 C9448 (N.D. ILL October 19, 1990)	21,22
In re Washington Public Power Supply System Securities Litigation, 823 F.2d 1349 (9th Cir. 1987)	19,20
Kennedy v. Tallant, 710 F.2d 711 (11th Cir. 1983)	18
Klein v. Shields & Co., 470 F.2d 1344 (2d Cir. 1972)	17
Nesbit v. McNeil, 896 F.2d 380 (9th Cir. 1990)	9
Newman v. Prior, 518 F.2d 97 (4th Cir. 1975)	17
Pinter v. Dahl, 486 U.S. 622 (1988)	17

	PAGE
Roberts v. Heim, 670 F. Supp. 1466 (N.D. Cal. 1987)	20
SEC v. Drexel Burnham Lambert, Inc., et al., Civil Action No. 88 CIV 6209 (S.D.N.Y. September 7, 1988)	21
Shields v. Keating, MDL 834 (D. Ariz. 1989)	21
Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385 (7th Cir. 1990)	passim
Sperry v. Barggren, 523 F.2d 708 (7th Cir. 1975)	17
State of Ohio v. Peterson, Lowry, Rall, Barber & Ross, 651 F.2d 687 (10th Cir.), *cert. denied*, 454 U.S. 985 (1981)	17-18
Stitt v. Williams, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95, 647 (9th Cir. December 12, 1990)	18-19
Tobacco & Allied Stocks, Inc. v. Transamerica Corp., 244 F.2d 902 (3d Cir. 1957)	17
Volk v. D.A. Davidson & Co., 816 F.2d 1406 (9th Cir. 1987)	9,17
Wachovia Bank & Trust Co. v. Nat'l Student Marketing Corp., 650 F.2d 342 (D.C. Cir. 1980), *cert. denied*, 452 U.S. 954 (1981)	18
Wilson v. Garcia, 471 U.S. 261 (1985)	9

STATUTES, RULES AND REGULATIONS

15 U.S.C.	
§77a	3
§77(m)	4,22
15 U.S.C.	
§78a	4,22
§78i(e)	4,22
§78j(b)	passim
§78r(c)	5,11,22

	PAGE
§78t(a)	2,22,26,23
18 U.S.C.	
§1964	8
Federal Rules of Civil Procedure	
Rule 9(b)	5,6,15,23
Rule 11	5,6,15, 20,23
Federal Rules of Evidence	
Rule 201	21
17 C.F.R.	
§240.10-5	passim

SECONDARY AUTHORITIES

Guin and Donaldson, *The Insider Trading and Securities Fraud Enforcement Act: Has Congress Supplied A Limitations Period For Use In Private 10b-5 Actions?*, 47 Wash. & Lee L. Rev. 541 (1990)	3,10-12
H.R. Rep. No. 910, 100th Cong. 2nd Sess. 26, reprinted in 1988 U.S. Code Cong., S. Admin. News 6063	23

QUESTION PRESENTED

Whether a non-tollable, one-year/three-year statute of limitations is appropriate for application to implied private actions under the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5 thereunder, 17 C.F.R. §240.10b-5.

INTEREST OF THE AMICUS CURIAE

As explained in the foregoing motion for leave to participate as amicus curiae, NASCAT is a national association of law firms consisting of approximately 500 attorneys located throughout the United States whose purpose is to facilitate protection of investors and other consumers through appropriate legislative and judicial activity.

This Court has repeatedly emphasized the need for private enforcement of the federal securities laws, and has consistently recognized that the securities laws should be flexibly construed to achieve the remedial purposes of those laws. The limitations period which is applied to claims under Section 10(b) of the Securities Exchange Act of 1934 will have a direct effect on the enforcement of those laws. As such, the issues presented in this case are extremely important to the investment community and the capital markets generally.

SUMMARY OF THE ARGUMENT

The non-tollable one-year/three-year statute of limitations which petitioner proposes be applied to Section 10(b) claims is not drawn from the law "most analogous" to Section 10(b). Because the implied right of action under Section 10(b) is a fraud claim, the "most analogous" law is state common law fraud. If this Court decides to look to federal law, Section 20A of the Securities Exchange Act of 1934 is more "analogous" to Section 10(b) than the law from which the non-tollable, one-year/three-year statute of limitations is drawn. Moreover, the long-standing doctrine of equitable tolling must be applied to the limitations period selected for Section 10(b) claims. Finally, if this Court determines that a different limitations period should apply to Section 10(b) claims than the current use of state statutes of limitations applicable to analogous state law, that decision should not be retroactive.

I. A NON-TOLLABLE ONE YEAR/THREE YEAR STATUTE OF LIMITATIONS IS NOT APPROPRIATE FOR APPLICATION TO 10b-5 CLAIMS

The question presented in this case is straightforward: whether a judicially-created, non-tollable statute of limitations should govern the timeliness of the assertion of the implied private right of action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5 thereunder, 17 C.F.R. §240.10b-5 ("10(b)" or "10b-5")? Petitioner argues for a non-tollable one-year/three-year period of repose, relying on the Third Circuit's creation of such a period from limitation statutes contained in various sections of the Securities Act of 1933, 15 U.S.C. §77a *et seq.* (the "1933 Act") and the Securities Exchange Act of 1934, 15 U.S.C §78a, *et seq.* (the "1934 Act"). *In re Data Access Securities Litigation*, 843 F.2d 1537 (3d Cir.), *cert. denied*, 488 U.S. 849 (1988).[1]

After *Data Access*, the Seventh Circuit adopted a different non-tollable, one-year/three-year statute of limitations for application to Section 10(b) claims in *Short v. Belleville Shoe*

[1] In *Data Access*, the Third Circuit created a limitations period which runs one-year from constructive discovery of the violation, but in no event more than three years from the violation. *Id.* at 1550. This is a limitations period with no counterpart in either the 1933 or 1934 Acts. Guin and Donaldson, *The Insider Trading and Securities Fraud Enforcement Act: Has Congress Supplied A Limitations Period For Use In Private 10b-5 Actions?*, 47 Wash. & Lee L. Rev. 541, 563-65 (1990). *See also* Section I.B., *infra*.

Mfg. Co., 908 F.2d 1385 (7th Cir. 1990).[2] Most recently, the Second Circuit concluded that a third version of the one-year/three-year rule applied to Section 10(b) claims in *Ceres Partners v. GEL Associates*, 918 F.2d 349 (2d Cir. 1990).[3]

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[2] In *Short*, the Seventh Circuit incorrectly stated that "*Data Access* selected §13 [of the Securities Act of 1933] as the appropriate federal law. . . . " *Id.* at 1390. Yet, in *Data Access*, the Third Circuit clearly decided that "the express limitations sections of the Securities Exchange Act of 1934 provide the preferable source of limitations borrowing here." 843 F.2d 1550. The Third Circuit then created its own version of the one-year/three-year rule. *See supra* note 1. Section 13 of the 1933 Act provides:

> No action shall be maintained to enforce any liability under section 11 or section 12(2) unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 12(1), unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 11 or section 12(1) more than three years after the security was bona fide offered to the public, or under section 12(2) more than three years after the sale.

15 U.S.C. §77(m). The Seventh Circuit in *Short*, held that Section 13 governed Rule 10b-5 claims and applied Section 13 to determine that plaintiff's claim was untimely filed. 908 F.2d at 1392-93.

[3] In *Ceres*, the Second Circuit incorrectly observed that the Seventh Circuit in *Short* concluded that "a more appropriate analogy than state limitation statutes was to be found in the 1934 Act itself." *Id.* at 359. In fact, in *Short*, the Seventh Circuit adopted Section 13 of the 1933 Act as the limitations period for Section 10(b) claims. *See supra* note 2. The Second Circuit in *Ceres*, concluded "that the statute of limitations provided in 1934 Act for express rights of action under §9(e) and 18(a)" should apply to Section 10(b) claims. *Ceres*, 981 F.2d 364.

Section 9(e) of the 1934 Act provides:

> No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

15 U.S.C. §78i(e). Section 18(c) of the 1934 Act states:

(footnote continues)

While non-tollable statutes of repose may be appropriate for the express rights of actions contained in the 1933 and 1934 Acts, any of the three limitation periods now being applied in the Third, Seventh and Second Circuits will hinder and in many cases eliminate the private enforcement of the federal securities laws now provided by 10b-5 actions. Moreover, the one-year/three-year rule stands in sharp contrast to this Court's mandate that the federal securities laws "should be construed 'not technically and restrictively, but flexibly to effectuate [their] remedial purposes.'" *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983) (citations omitted).

The one-year/three-year rule will certainly reduce 10b-5 litigation, but at an unacceptable cost. Defrauded investors, who have relied upon the integrity of this country's capital markets, will be left without recourse or remedy under the very federal laws that were designed to protect them, while the perpetrators of fraud will not be held to account for their conduct. Such a result is inconsistent with (i) a flexible construction of the securities laws designed to achieve the remedial purposes of those laws; and (ii) other federal procedural requirements, including Rules 9(b) and 11 of the Federal

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(footnote continued)

> No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued.

15 U.S.C. §78r(c).

Thus, plaintiffs and defendants in the Second Circuit are faced with the question whether the three year period commences with the "violation" or accrual of the "cause of action."

Rules of Civil Procedure, which were adopted to discourage overly precipitous fraud actions.[4]

The Supreme Court has outlined the following process for selecting a statute of limitations to be applied to a cause of action when Congress is silent on the questions (*Agency Holding Corp. v. Malley-Duff & Assoc., Inc.*, 483 U.S. 143, 147 (1987)):

> 1. The first step in selecting the appropriate statute of limitations is to characterize the federal claim (which is usually a question of federal law), by determining whether all claims arising out of the federal statute will be characterized in the same way, or evaluated differently depending upon the facts and legal theories of each claim. *Id.*
>
> 2. The next question is whether a federal or state statute of limitations should be applied. The Rules of Decision Act, 28 U.S.C. §1652, requires the use of a state statute; only in limited circumstances (483 U.S. at 147) should a limitations statute "from elsewhere in the federal law . . . be applied." *DelCostello v. International Bhd. of Teamsters*, 462 U.S. 151, 159 n. 13.

[4] Judge Easterbrook's comments in the Seventh Circuit's *Short* opinion demonstrate an insensitivity both to the plight of a defrauded investor caught between the *Short* limitations period and Rules 9(b) and 11, and to this Court's long history of support for a flexible construction of the securities laws. In *Short*, Judge Easterbrook noted that with a shorter period of time, investors will "have a more powerful incentive to investigate rather than accept another person's word without question. . . . Prudent investors can almost always sniff out fraud (or enough smoke to justify litigation) within three years. *Section 13 cuts off only the claims of the most trusting* or somnolent — or the most wily, those who wanted to wait as long as possible." *Short*, 908 F.2d at 1392 (emphasis added). Fortunately, investors can look to this Court's firm and unwavering support of the protections afforded by the federal securities laws.

> 3. A statute of limitations from elsewhere in the federal law may be appropriate if the characterization of the federal claim leads to the conclusion that state statutes of limitation are "unsatisfactory vehicles for the enforcement of federal law." *Id.* at 161.
>
> 4. The court must then determine that (i) there is a rule in federal law which provides a closer analogy than available state statutes, and (ii) federal policies at stake and the practicalities of litigation make the federal rule "a significantly more appropriate vehicle for interstitial lawmaking. . . . " *Id.* at 171-72.

Agency Holding, 483 U.S. at 147-48.

A. Characterization Of A Section 10(b) Claim

As this Court recognized in both *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) and *Herman & MacClean v. Huddleston*, the right of action implied under Section 10(b) and Rule 10b-5 is a fraud claim. Congress adopted Section 10(b) to combat fraud (425 U.S. at 206), and the courts implied a private right of action under Section 10(b) to encourage and enable private enforcement of this significant anti-fraud provision of the federal securities laws (425 U.S. at 185); *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) ("a private cause of action exists for a violation of §10(b) and Rule 10b-5 and constitutes an essential tool for enforcement of the 1934 Acts' requirements"). While the provision was designed to combat a wide variety of conduct, the essence of that conduct is the same in every claim filed under this section: fraud in connection with the purchase or sale of securities. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975). Section 10(b) claims do not involve multiplicity of different types of claims and thus one uniform federal standard is not necessary.

By contrast, civil claims for violation of the Racketeer Influenced And Corrupt Organizations Act ("RICO"),

18 U.S.C. §1964, may involve mail fraud, wire fraud, securities fraud, arson, bribery, theft, political corruption, breach of contract, fraud, conversation, tortious interference with business relations, misappropriation of trade secrets, unfair competition, usury and disparagement. *Agency Holdings*, 483 U.S. at 149. Moreover, RICO "enterprise" and "pattern of racketeering activity" are concepts unknown in the common law. *Id.* at 150. Thus, this Court concluded in *Agency Holdings* that because a multiplicity of limitations periods were applicable to the wide variety of conduct encompassed by RICO, "a uniform statute of limitations is required to avoid intolerable uncertainty and time-consuming litigation." *Id.* (Citation omitted.)

To identify the appropriate limitations statute for a 10b-5 claim, therefore, there is no need to evaluate the facts and legal theories of each claim. Because a 10(b) claim should always be characterized as a fraud claim, the characterization of the claim does not lead to the conclusion that state statutes of limitations "are an unsatisfactory vehicle for the enforcement of federal law." To the contrary, use of state limitations periods for Section 10(b) actions has not frustrated or interfered with the vigorous enforcement of the antifraud provisions of the federal securities laws upon which this Court and Congress have long insisted. *See, e.g., Basic*, at 231, 244-45.

As long as a Section 10(b) claim is consistently characterized as a fraud claim, and federal district courts look to a single state statute for the appropriate limitations period, the objectives of private enforcement of the federal securities laws will be met. Nothing in federal law or policy requires that all Section 10(b) actions be governed by a single, invariable limitations period. Moreover, the Third, Seventh and Second Circuits' *Data Access*, *Short*, and *Ceres* decisions have not achieved the stated goal of uniformity (*see, e.g., Data Access*, 843 F.2d at 1549). The use of the one year/three year statute of limitations will have an adverse effect upon the

enforcement of the securities laws, an effect which far outweighs any benefit which might result from the use of the various federal limitations periods created or selected by the Third, Seventh and Second Circuits.

This Court has not mandated the application of a single limitations period to causes of action for which Congress has not adopted an express statute of limitations. In *Wilson v. Garcia*, 471 U.S. 261 (1985), this Court held that state law causes of actions were more analogous to Section 1983 claims than federal causes of action, and therefore applied a limitations period drawn from state law. This Court further concluded that "federal interests in uniformity, certainty and the minimization of unnecessary litigation" favored the selection, in each state, of "the one most appropriate statute of limitations for all § 1983 claims." 471 U.S. at 275.

The Ninth Circuit recently rejected a request for *en banc* review of its prior decisions in *Davis v. Birr, Wilson & Co.*, 839 F.2d 1369 (9th Cir. 1988) and *Volk v. D.A. Davidson & Co.*, 816 F.2d 1406 (9th Cir. 1987). In *Davis* and *Volk*, the Ninth Circuit reaffirmed the selection of the single limitations period in each state for common law fraud for Section 10(b) claims. *Nesbit v. McNeil*, 896 F.2d 380, 384 (9th Cir. 1990). The Ninth Circuit further concluded in *Nesbit* that this Court's opinions in *Wilson* and *Agency Holding* "do not compel a reassessment and reversal of our position." *Id.*

Were courts to apply a single statute of limitations to all Rule 10b-5 claims arising within a state, much of the unnecessary litigation complained about in *Data Access*, *Short*, and *Ceres* would be cured. While the limitations period for Rule 10b-5 claims may vary from state to state, it is a simple

matter to determine the period within each state.[5] Uniformity within each state will be achieved without violating this Court's precedents and without severely limiting Rule 10b-5 claims.

B. The One-Year/Three Year Rule Does Not Provide A "Closer Analogy" To Section 10(b) Than Available State Law Fraud Statutes

Relying upon *Data Access*, *Short*, and *Ceres*, petitioner asks this Court to apply to Section 10(b) claims "a uniform federal statute of limitations — the one-year/three-year period contained in most of the express remedy provisions of the federal securities laws." Petitioner's Brief at 32. Petitioner suggests that "every one" of the express rights of action in the 1933 and 1934 Acts "is governed by an identical limitations period" and that these express rights of action provide a "far closer analogy" to Section 10(b) than any state law alternative. Because petitioner's assumptions are incorrect, so is its conclusion.

First, virtually all of the express remedies in the 1933 and 1934 Acts to which non-tollable limitations periods apply are not fraud claims. *Hochfelder*, 425 U.S. at 208, 209 n.28. *See also* Respondents' Brief at §III A. Second, each of the express rights of action in the 1933 and 1934 Acts is governed by a different statute of limitations,[6] and the limitations period crafted by the Third Circuit in *Data Access* is different still.

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[5] NASCAT agrees with respondents that common law fraud provides the "closest analogy" to Section 10(b) and therefore the state limitations period for common law fraud should apply to Section 10(b) claims.

[6] [C]lose examination of the various express limitations periods in [the 1933 and 1934] Acts reveals that no two are identical.

(footnote continues)

Third, this Court has already rejected the "closer analogy" argument. Application of a one-year/three-year limitations period to 10b-5 claims conflicts with this Court's decisions in *Hochfelder* and *Huddleston*, which decisions (in

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(footnote continued)

Section 13 of the 1933 Act provides the limitation periods for actions brought under Securities Act sections 11 and 12. For actions under section 11, the limitations period is one year from discovery of the true facts, or after discovery should have been made by the exercise of reasonable diligence, but no more that three years after the security was bona fide offered to the public. The limitations period for section 12(1) actions is one year after the "violation," but no more than three years after the security was bona fide offered to the public. The limitations period for section 12(2) actions is one year from discovery of the true facts, or after discovery should have been made by the exercise of reasonable diligence, but no more than three years after the "sale."

The 1934 Act contains statutes of limitation for the express civil causes of action under sections 9, 16, 18, and 29. The limitations period for actions brought under section 9(e) is one year from discovery of the facts constituting the cause of action, but no more than three years after "violation" of the section. A claim under section 16(b) is in the nature of a derivative action on behalf of the issuer, and the outside limit on commencing an action is two years after the insider realized a "short-swing" profit. The limitations period for violations of section 18(c) is one year from discovery of the facts constituting the cause of action, but no more than three years after the "cause of action accrued." The limitation period for a right of rescission under section 29 is one year after discovery that the purchase or sale of the security involved a violation of the Act, but no more than three years after the "violation."

The Third Circuit was deceived by the similarities among all these limitation periods and overlooked their significant differences. Only the limitation periods in the 1933 Act begin running from the time "discovery should have been made by the exercise of reasonable diligence. . . . " Presumably, the one year from discovery rules in the 1934 Act start to run not when the plaintiff should reasonably have been placed on inquiry, but only after the plaintiff has *actual notice* of *facts* that make up the violation. Because the Third Circuit never recognized this distinction, it purported to adopt both types of rules and never clarified whether it would impose a reasonable diligence standard on plaintiffs.

(footnote continues)

Hochfelder, to impose a scienter requirement on 10b-5 claims and in *Huddleston*, that the express liability provisions of the Acts and 10b-5 actions were not mutually exclusive) were both based in large part upon an assumption that the limitations period in a Section 10(b) case was longer than the limitations periods applicable to the express rights of action in the 1933 and 1934 Acts. *Hochfelder*, 425 U.S. at 210 n.29;[7] *Huddleston*, 459 U.S. at 384 n.18.

(footnote continued)

In addition, the three year outside limits of some of the express periods begin to run from the date of "sale," whereas others run from the date of the "violation" or from the "accrual of the claim." The Third Circuit undertook no analysis of these distinctions and simply adopted the rules using the "violation" as the starting point. In 10b-5 litigation, however, the time of the "violation" need not equate with the time of the sale." For example, in actively traded securities, a corporation may issue a press release containing materially false and misleading representations as to its financial condition. A month or more later, an investor may buy shares of that corporation's stock in reliance on the previously issued press release. Arguably, the "violation" occurred at the time the press release was issued, but the "sale" did not occur for another month, and the investor's cause of action could not have "accrued" until he purchased the stock. The Third Circuit made no effort to clarify which of these various periods it was adopting, nor did it state why it chose a three year period running from the violation rather than the sale.

Guin, *supra* note 1, at 564-65 (citations omitted).

[7] In *Hochfelder*, the Securities and Exchange Commission urged this Court to adopt a negligence standard of liability for Section 10(b) claims similar to the standards for claims brought under Section 11 and 12 of the 1933 Act. The Court carefully reviewed and compared Section 10(b) and Sections 11 and 12 and rejected the Commission's argument, stating that the claims under the 1933 Act which contain a negligence standard are subject to "significant procedural restrictions not applicable under §10(b)." 425 U.S. at 208-09. In reaching this conclusion, the Court explicitly referred to the differences between the statutes of limitations applicable to 1933 Act claims and Section 10(b) claims as being one of the significant procedural restrictions. The Court stated:

(footnote continues)

Fourth, the imposition of a non-tollable one-year/three-year statute of limitations upon Section 10(b)'s private right of action is contrary to this Court's directive to interpret and construe the federal securities laws flexibly in order to effectuate the "broad remedial purposes" of those laws. *Huddleston*, 459 U.S. at 386. Unlike the current precedent of this Court requiring the use of state limitations periods, application of a one-year/three-year period to 10b-5 claims would severely restrict the commencement of such claims (*see infra* at §§I.D. and I.E.), and thereby hinder this Court's oft-stated objective of facilitating and encouraging the private enforcement of the federal securities laws. *Basic*, 485 U.S. at 231, 244-45. The one-year/three-year, therefore, does not provide a "closer analogy" to Section 10(b) than state law.

C. Federal Policies At Stake And The Practicalities Of Litigation Do Not Make The One-Year/Three-Year Rule A More Appropriate Vehicle For Interstitial Lawmaking

The Ninth Circuit has refused to follow the Third, Seventh and Second Circuits which have decided two issues now presented in this case. First, the Third, Seventh and Second Circuits have each held that instead of applying a state statute of limitations to a claim brought pursuant to Section 10(b) of the 1934 Act, each circuit would apply a federal, albeit different, one-year/three-year statute of limitations. Second, each circuit has held that no tolling of the limitations period would be permitted in this Section 10(b) fraud action. Both holdings

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(footnote continued)

> Since no statute of limitations is provided for civil actions under §10(b), the law of limitations of the forum State is followed as in other cases of judicially implied remedies. *See Holmberg v. Armbrecht*, 325 U.S. 392, 395, 66 S. Ct. 582, 584, 90 L.Ed. 743, 746 (1946), and cases cited therein. Although it is not always certain which state statute of limitations should be followed, such statutes of limitations usually are longer than the period provided under §13. 3 Loss, *supra*, n.17 at 1773-1774. . . .

425 U.S. at 210 n.29.

contravene explicit rulings of this Court and both holdings create clear conflicts among the circuits (and even among the Third, Seventh and Second Circuits).

The Court is, of course, aware of the crucial role that private actions under Section 10(b) and Rule 10b-5 play in enforcement of the federal securities laws. Recently, this Court reemphasized that "a private cause of action . . . for a violation of §10(b) and Rule 10b-5 . . . constitutes an essential tool for enforcement of the 1934 Act's requirements." *Basic*, 485 U.S. at 231. In adopting the *Basic* "fraud-on-the-market" presumption of reliance for Section 10(b) class actions, the Court likewise reminded us of the vital role that class actions play in enforcing the antifraud provisions of the securities laws. *Id* at 243-44. No question may be more important to the maintenance of a cause of action and therefore to the private enforcement of the federal securities laws, than the statute of limitations applicable thereto. Because venue is national in securities fraud class actions, the one-year/three-year rule which fixes the limitations period for Section 10(b) claims at one year after the discovery and a maximum of three years after the occurrence, accrual, sale or a *bona fide* offering (depending on the rule or circuit), has significant practical implications for the conduct of private securities fraud class actions throughout the United States.

D. The One-Year/Three-Year Statute Is Non-Tollable And Eliminates For The First Time The Equitable Tolling Of A Limitation Period Applicable To A Fraud Class

In issuing its decisions prohibiting tolling of the newly fashioned one-year/three-year limitations periods in cases of securities fraud, the Third, Seventh and Second Circuits failed to adhere to this Court's precedents that "read into every federal statute of limitation" the equitable doctrine of

fraudulent concealment.[8] *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946). For over a century, this Court has required that a tolling provision be appended to all limitations periods, applicable to lawsuits sounding in fraud, to the end that "no man may take advantage of his own wrong." *Glus v. Brooklyn Eastern District Terminal*, 359 U.S. 231, 232 (1959).

In an unbroken line of cases decided over the past 115 years, this Court has consistently and without deviation required that equitable tolling be read into all limitations periods governing causes of action sounding in fraud. This in itself is not surprising, since by its very nature fraud in all its forms is self-concealing. Its victims by definition are unaware of their status when the fraud is committed, and remain in ignorance as long as its perpetrators can conceal their wrongdoing. Tolling the applicable statute of limitations is thus the only mechanism by which a cause of action to redress the injury can be preserved. As this court explained over a century ago, "[t]o hold that by concealing a fraud, or by committing a fraud in a manner that it concealed itself until such time as the party committing the fraud could plead the statue of limitations to protect it, is to make the law which was designed to prevent fraud the means by which it is made successful and secure." *Bailey v. Glover*, 88 U.S. 342, 349 (1875). In *Exploration Co. v. United States*, 247 U.S. 435, 449

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[8] In addition to non-tolling, this rule is also objectionable because it requires filing of a Section 10(b) claim within one year from initial or "constructive" discovery of the fraud. In many cases, that will simply not be enough time for defrauded investors to determine the parameters, participants and details of the fraud sufficient to satisfy Rules 9(b) and 11 of the Federal Rules of Civil Procedure. This is particularly important today, as the complexity and size of frauds has increased and grown, and as frauds now often include not only primary defendants, but legal and accounting professionals as well. While the initial scope of a fraud and its perpetrators may be apparent within one year, it is often the case that the magnitude of the fraud and those involved are not fully known until many years later.

Even the Securities Exchange Commission requires, on average, 2.25 years to complete its fraud investigations. SEC Amicus Brief at 30.

(1918), this Court reaffirmed "the rule . . . that statutes of limitations to set aside fraudulent transactions shall not begin to run until the discovery of the fraud." More recently, in *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946), this Court again had occasion to hold that "the old chancery rule" of equitable tolling "is read into every federal statute of limitations."

"Statutes of limitations are primarily designed to assure fairness to defendants." *Burnett v. New York Central R.R.*, 380 U.S. 424, 428 (1965). Prompted by "considerations deeply rooted in our jurisprudence," "in cases where the plaintiff has refrained from commencing suit during the period of limitations because of inducement by defendant, or because of fraudulent concealment, this Court has not hesitated to find the statutory period tolled or suspended by the conduct of the defendant." *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 559 (1974). *See Board of Regents v. Tomanio*, 446 U.S. 478, 487-88 (1980).

The Third Circuit's *Data Access* decision squarely holds that "the proper period of limitations for a complaint charging violation of Section 10(b) and Rule 10b-5 is . . . in no event more than three years after [the] violation." 843 F.2d at 1550. This is error. In failing to adhere to this Court's precedents that tolling is mandatory in all cases of fraud, the Third Circuit created an unwarranted exception to the "universal rule" (*Exploration Co. v. United States*, 247 U.S. at 449) that tolling is read into every limitations period governing claims that sound in fraud.

The practical effect of the adoption of a non-tollable one-year/three-year statute of limitations will be to encourage securities law violators to conceal their wrongdoing for the period of time required to extinguish all civil Section 10(b) claims that would otherwise be brought against them. Such concealment is often not difficult since the perpetrators of

stock fraud schemes are likely to be skilled and highly motivated businessmen with exclusive knowledge of the facts surrounding their conduct, while their victims are public shareholders and investors who, in ignorance of the fraud, have relied on the integrity of the price of their stock set by the workings of the impersonal securities market. *See Basic*, 485 U.S. at 245-46.

Likewise, imposition of an absolute three-year cut-off of the right to sue under Section 10(b), as required by the *Data Access* decision, flies in the face of what the Court again recently recognized as "the Congressional policy embodied in the 1934 Act" of "facilitating Rule 10b-5 litigation." *Basic*, 485 U.S. at 245. Contrary to "the congressional policy favoring private suits as an important mode of enforcing federal securities statutes" (*Pinter v. Dahl*, 486 U.S. 622, 633 (1988)), what the *Data Access* decision promises to achieve is stultification of Rule 10b-5 litigation and absolute immunity from suit, from both private plaintiffs and from the Securities and Exchange Commission, for all who successfully conceal their fraud for three years.

Until the *Data Access* decision, the law in every circuit was that the running of the limitations period applicable to Section 10(b) securities fraud actions must be suspended until the fraud is, or with the exercise of reasonable diligence should have been discovered. *Holmes v. Bateson*, 583 F.2d 542, 561 (1st Cir. 1978); *Klein v. Shields & Co.*, 470 F.2d 1344, 1346 (2d Cir. 1972); *Tobacco & Allied Stocks, Inc. v. Transamerica Corp.*, 244 F.2d 902, 903 (3d Cir. 1957); *Newman v. Prior*, 518 F.2d 97, 100 (4th Cir. 1975); *Breen v. Centex Corp.*, 695 F.2d 907, 911 (5th Cir. 1983); *Herm v. Stafford*, 663 F.2d 669, 682 (6th Cir. 1981); *Sperry v. Barggren*, 523 F.2d 708, 710 (7th Cir. 1975); *Harris v. Union Electric Co.*, 787 F.2d 355, 360 (8th Cir.), *cert. denied*, 479 U.S. 823 (1986); *Volk v. D.A. Davidson & Co.*, 816 F.2d at 1412; *State of Ohio v. Peterson, Lowry, Rall, Barber & Ross*, 651 F.2d 687, 691-92 (10th Cir.), *cert. denied*, 454 U.S. 985

(1981); *Kennedy v. Tallant*, 710 F.2d 711, 716 (11th Cir. 1983); *Wachovia Bank & Trust Co. v. Nat'l Student Marketing Corp.*, 650 F.2d 342, 349 (D.C. Cir. 1980), *cert. denied*, 452 U.S. 954 (1981). The Circuits' unanimous adherence to this principle stemmed from this Court's insistence on suspending the limitations period for victims of a fraudulent scheme until their discovery of the fraudulent conduct, a rule that safeguards against the possibility that wrongdoers will escape the consequences of their actions by concealing their fraud until the statute of limitations has run.

The Third Circuit did not acknowledge this Court's precedents applying this "universal rule." *Exploration Co. v. United States*, 247 U.S. at 449. Nor did it acknowledge that its decision has created a conflict among the circuits on the point. Instead, without discussion or analysis, it held that its newly created "one-year/three-year" limitations period for Section 10(b) claims is "absolute" and not subject to tolling.

Rejection of the non-tollable, one-year/three-year rule is warranted to correct the Third, Seventh and Second Circuits' failure to adhere to this Court's precedents on the question of tolling, as well as to repair the damage to both private and governmental securities enforcement efforts created by the decision, which promises to reward fraudulent conduct by immunizing it from challenge if it can be concealed until expiration of the three-year outer limitations period created by the *Data Access* decision.

E. The One-Year/Three-Year Period Would Undermine The Private Enforcement Of The Securities Laws

The *Data Access*, *Short* and *Ceres* decisions eliminate a significant source of protection for defrauded investors who, as a result of the defrauder's efforts, do not learn of the fraud until long after the wrong has been perpetrated. The doctrines of equitable tolling and equitable estoppel have long been available to toll limitations periods when the fraud is concealed. *Stitt v. Williams*, [Current Transfer Binder] Fed. Sec.

L. Rep. (CCH) §95,647 (9th Cir. December 12, 1990). Availability and application of these doctrines serves to further two policies enunciated by this Court on repeated occasions throughout its history of reviewing and interpreting the 1933 and 1934 Acts: the flexible construction of the Acts to effectuate their remedial purposes, and the private enforcement of the securities laws. *Basic*, 485 U.S. at 231, 245-46; *Huddleston*, 459 U.S. at 386; *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310, (1985). Eliminating these common law doctrines would have an adverse impact upon the ability of private plaintiffs to assert violations of the securities laws, and therefore upon the enforcement of those laws, encouraging those who would defraud to do so and to do so in a manner which disguises their wrongdoing until the non-tollable limitations period expires.

There are untold numbers of investors who would never have recovered at all had such a draconian limitations period been in place. Perhaps the most poignant example involves the purchasers of $2.25 billion of municipal bonds issued by the Washington Public Power Supply System ("WPPSS") between 1977 and 1981 to finance the construction of two nuclear power plants. The Supply System ceased constructing these power plants in 1982 and thereafter defaulted on the $2.25 billion bonds. On March 8, 1983, plaintiffs filed a class action alleging that defendants violated federal and state securities laws by making materially false and misleading statements to sell the bonds to the public. *See In re Washington Public Power Supply System Securities Litigation*, 823 F.2d 1349 (9th Cir. 1987). Following hard-fought litigation, the case was settled for in excess of $700 million.

The massive harm caused by the WPPSS bond fraud would never have been remedied for thousands of investors had the non-tollable *Data Access* limitations period been in effect. Under such a limitations period, anyone who purchased a WPPSS bond prior to March 8, 1980 (three years prior to the filing of plaintiffs' WPPSS complaint) would have

been barred from bringing suit to remedy the harm caused by the ongoing six-year fraud. Instead, this purchaser would have been expected to bring suit at a time when the fraud was fully concealed and in the face of the strictures imposed upon counsel by Rule 11 of the Federal Rules of Civil Procedure, while defendants continued to sell WPPSS bonds to the public for at least another three years. In real terms, pre-March 8, 1980 purchasers of $1.5 billion of WPPSS bonds would have never recovered for defendants' violations of the federal securities laws.

Similarly, victims of the most egregious acts of securities fraud, such as long-running pyramid or Ponzi schemes, would have no remedy under the *Data Access* "solution" so long as defendants could hide the true facts from investors for three years. Indeed, under *Data Access*, investors in multi-offering limited partnership schemes are particularly disenfranchised: these schemes typically run over a course of several years before collapse. Because the investment programs themselves are long term, early as well as late investors lose everything upon the program's demise. The federal courts have consistently recognized that *all* investors defrauded in a long-term Ponzi scheme should have recourse under Rule 10b-5. For example, under a *Data Access* rule, most of the 3,000 investors in the twelve-year, multi-offering Ponzi scheme described in *In re Home-Stake Production Co. Securities Litigation*, 76 F.R.D. 351, 358-61 (N.D. Okla. 1977); the 3,000 investors in the 40-partnership, four-year Ponzi scheme described in *Roberts v. Heim*, 670 F. Supp. 1466, 1473-75 (N.D. Cal. 1987); and the nine-year,multi-offering oil and gas Petro-Louis Ponzi scheme described in *Bresson v. Thomson McKinnon Securities Inc.*, 118 F.R.D. 339, 341 (S.D.N.Y. 1988), would have been left without recourse under the federal securities laws. Instead, these investors sustained their claims and ultimately recovered damages, via settlement or judgment.

The unfairness of this rule and current events dictate a different result. If a one-year/three-year rule is adopted by this Court, victims of the most visible frauds of our day may be denied recovery for their injuries under the federal securities laws. The scandals involving Drexel Burnham Lambert and Michael Milken include transactions which span the 1980's and it was not until the September 7, 1988 filing of the SEC's civil indictment naming Drexel, Milken and others that the wrongdoing of Drexel and Milken was first publicly exposed. *SEC v. Drexel Burnham Lambert, Inc., et al.*, Civil Action No. 88 CIV 6209 (S.D.N.Y. September 7, 1988).[9] Under the one-year/three-year rule, investors harmed by Drexel or Milken's conduct prior to September 1985 will be precluded from asserting a Section 10(b) claim.[10]

The most recent example of the inequitable and arbitrary adverse effect of the application of a non-tollable, one-year/three-year statute of limitations to a Section 10(b) claim is the district court's October 19, 1990 decision in *In re VMS Securities Litigation*, 89 C 9448 (N.D. Ill.) (Slip Op. at 24). Between 1984 and 1988, in a series of public offerings, VMS sold limited partnerships in VMS entities that developed commercial real estate. *Id.* at 5-10. On December 22, 1989, plaintiffs filed suit, alleging that defendants had materially misrepresented real estate values, office space projection and the structure of the partnership interests, thereby violating,

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[9] Pursuant to Rule 201 of the Federal Rules of Evidence, NASCAT requests that the Court take judicial notice of the judicial records referred to in this section.

[10] Similarly, the Sixth Amended Complaint in *Shields v. Keating, et al.*, MDL 834 (D. Ariz. 1989), commonly known as the American Continental/Lincoln Savings Securities Litigation, encompasses more than a three-year period (January 1, 1986 through April 14, 1989) and perforce under a one-year/three-year rule, many of the defrauded purchasers of American Continental securities would not be permitted to pursue Section 10(b) claims against, *inter alia*, Charles Keating, other officers and directors of American Continental and American Continental's auditors and counsel.

inter alia, Section 10(b). By adopting the one-year/three-year rule, the court eliminated the Section 10(b) claims of individuals who purchased approximately $475 million of limited partnership interests from the defendants during a four-year period in which defendants sold approximately $1 billion of such interests. *Id.* This wholly unfair and arbitrary result occurred even though (i) all of the VMS plaintiffs were victims of the defendants' same, ongoing, wrongful course of conduct; and (ii) the VMS plaintiffs did not become aware of their claims until November 14, 1989. *Id.* at 25.

II. THE FIVE-YEAR STATUTE OF LIMITATIONS IN SECTION 20A OF THE SECURITIES ACT OF 1934 IS "MORE ANALOGOUS" THAN THE ONE-YEAR/THREE-YEAR PERIOD AND WOULD PROMOTE, RATHER THAN EVISCERATE, THE PRIVATE ENFORCEMENT OF THE SECURITIES LAWS

If this Court nevertheless concludes that the limitations period for Rule 10b-5 claims should be found in federal, not state law, we have demonstrated above why application of the limitations periods found in Section 13 of the 1933 Act or Sections 9 and 18 of the 1934 Act would be inappropriate. Rather, this Court should apply the five-year limitation period of Section 20A of the 1934 Act.[11] Section 20A, known as the Insider Trading and Securities Fraud Enforcement Act

[11] NASCAT joins in the arguments of the Securities and Exchange Commission in support of the application of Section 20A's statute of limitation to 10b-5. *See* SEC Amicus Brief at 21-34. NASCAT does not, however, agree with the SEC's position that equitable tolling of Section 20A should not be permitted. As Judge Easterbrook noted in the Seventh Circuit's *Short* decision, there is nothing in the legislative history to suggest that Section 20A is other than a traditional, ordinary statute of limitations, without the restrictive, three-year language of the other limitation periods in the 1933 and 1934 Acts. 908 F.2d at 1391. For the reasons set forth *supra* in §§I.D.-I.E., equitable tolling should apply to Section 20A's limitations period.

of 1988, was passed to "augment enforcement of the securities laws, particularly in the area of insider trading." H.R. Rep. No. 910, 100th Cong., 2nd Sess. 26, reprinted in 1988 U.S. Code Cong., & Admin. News 6063, at 7. It provides express civil liability for "contemporaneous traders" of those trading on inside information and was developed to complement Rule 10b-5 claims based on insider trading. *Id.* at 157. At the time it was passed, Congress did not create a provision that contained an express cause of action for persons other than "contemporaneous traders" because it did not want to freeze the law and instead wanted "to give the courts leeway to develop implied private rights of action in an expansive fashion in the future." *Id.* at 27. Thus, Section 20A not only represents Congress' latest thoughts on limitations periods, but was passed against the backdrop of various interpretations of Rule 10b-5 and was crafted so as to ensure that the courts had leeway to develop Rule 10b-5 actions, which could overlap with Section 20A claims, in an "expansive fashion in the future." Accordingly, if Congress intended any federal limitations period to apply to Rule 10b-5 claims, this limitations period would be the five-year statute recently enacted (with full knowledge of the development of the law regarding Rule 10b-5), rather than the system created over fifty years ago.[12]

[12] In *Short*, the Seventh Circuit argues that the five-year limitations period in Section 20A is too long because "prudent investors almost always can sniff out fraud (or enough smoke to justify litigation) within three years. Section 13 cuts off only the claims of the most trusting or somnolent. . . . " 908 F.2d at 1392. There is *no* empirical evidence supporting this insensitive view, and, as it intentionally leaves the most defenseless group of investors without a remedy under the securities laws, it should not be given much weight. Moreover, under Rule 9(b) of the Federal Rules of Civil Procedure, investors are not *permitted* to file fraud allegations under Rule 10b-5 simply because they suspect fraud or can smell a whiff of "smoke." To do so would suggest sanctions under Rule 11 of the Federal Rules of Civil Procedure.

III. ANY STATUTE OF LIMITATIONS WHICH MAY BE SELECTED FROM FEDERAL LAW AND APPLIED TO SECTION 10(b) CLAIMS SHOULD NOT BE RETROACTIVE

Even if the Court decides to apply the *Data Access* one-year/three-year limitations period to Rule 10b-5 claims, it should not do so retroactively.

In *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07 (1971), the Supreme Court held that a newly announced rule of law should not be applied retroactively when (1) the new rule overrules clear past precendent on which litigants may have relied; (2) its purpose and effect would not be substantially furthered by retroactive application; and (3) imposing the rule retroactively would produce inequitable results because it would impose hardship or prejudice. Although the majority in *Data Access* did not decide the issue of retroactivity, a strong dissent by three judges on the *en banc* panel applied the *Chevron Oil* test, and concluded that the one-year/three-year rule should not be applied retroactively. *Data Access*, 843 F.2d at 1552-53 (Judge Seitz dissenting). *See also In re National Smelting of New Jersey, Inc. Bondholders' Litigation*, 722 F. Supp. 152, 158-60 (D.N.J. 1989) (refusing to apply the one-year/three-year rule retroactively).

Application of the *Chevron Oil* test inevitably leads to the conclusion that the *Data Access* rule should not be applied retroactively. First, application of the *Data Access* rule would be a clear departure from precedents in all circuits upon which plaintiffs may have relied, especially since plaintiffs would be deprived of their right to sue because the statute had run prior to the time they had any reason to believe that the fraud was perpetrated. Second, as set forth above in §I.E., retroactive application would deprive thousands of defrauded investors of any remedy whatsoever. While this certainly would be a fortuitous event for the defendants in the affected actions, it would do nothing to advance the purposes of the securities laws. Moreover, only applying the new rule

prospectively would not significantly further or retard the policy objectives underlying the *Data Access* decision. Third, it would be inequitable to deprive plaintiffs of their right to bring Section 10(b) claims when they did not know that the defendants would be able to avoid liability for any wrongdoing simply be hiding the true facts for three years. This would be a gross injustice, since plaintiffs would suddenly be exposed to fraud without the protection offered by the equitable tolling doctrine. As this Court stated in *Chevron Oil*, "[i]t would . . . produce the most 'substantial inequitable results' to hold that [plaintiff] 'slept on his rights' at a time when he could not have known the time limitations that the law imposed upon him . . . [N]onretroactive application here simply preserves his right to a day in court." 404 U.S. at 108 (citation and footnote omitted).

Recently the Third Circuit refused to apply its *Data Access* decision retroactively in *Gruber v. Price Waterhouse*, 911 F.2d 960 (3d Cir. 1990). In *Gruber*, the Third Circuit found that components one and three of the *Chevron* test "mandate prospective application in cases where a new period of limitations replaces a well-settled statute since it would be inequitable to change the rules in midstream when clear precedent had been relied upon." *Id.* at 968. The *Gruber* decision was recently followed in *Haumann v. Illinois Power Co., et. al*, Civil Action No. 89-1130 (C.D. Ill. December 4, 1990). The court concluded in *Haumann* that the Seventh Circuit's opinion in *Short* overruled clear past precedent upon which the litigants may have relied, and that to apply the *Short* decision retroactively would produce substantial inequitable result. Transcript of Hearing at 4, 8.

Accordingly, this Court should not apply the *Data Access* one-year/three-year rule retroactively.

IV. CONCLUSION

Application of a non-tollable, one-year/three-year statute of limitations to Section 10(b) claims would hamper the

effectiveness of the Section and hinder this Court's frequently-repeated objective of the facilitation and encouragement of private enforcement of the federal securities laws. Accordingly, the decision of the Ninth Circuit Court of Appeals should be affirmed.

If this Court concludes that it must look to federal law for a Section 10(b) limitations period, then the Court should adopt the limitations period contained in Section 20A of the 1934 Act. Section 20A's limitations period, with equitable tolling, is more analogous to Section 10(b) than the one-year/three-year rule and will maintain this Court's long line of precedents which support the private enforcement of the securities laws.

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